



Rating Action: **Moody's affirms Botswana's A3 ratings and maintains stable outlook**

27 Oct 2023

London, October 27, 2023 – Moody's Investors Service (Moody's) has today affirmed the Government of Botswana's long-term local and foreign currency issuer ratings at A3 and maintained the outlook at stable.

The rating affirmation is supported by the country's very low debt levels and its robust institutional frameworks and governance strength, balancing reduced fiscal buffers and economic concentration in mining and related activities. Very low susceptibility to political-, liquidity- and banking-related event risks also supports the affirmation.

The stable outlook reflects balanced risks. The global outlook for the diamond industry has softened but Botswana may be somewhat insulated from the slowdown. Botswana's latest infrastructure and economic diversification drive would support its credit profile if successful in developing a dynamic and competitive private sector. Meanwhile, Botswana's credit profile remains exposed to fiscal shocks given the depletion in its fiscal buffers, which reduces its credit profile's resilience to potential social risks, such as very high-income inequality and persistently high unemployment. However, continuing strong governance and robust institutions support the sovereign's capacity to respond to shocks despite the decreased fiscal buffers.

Botswana's local currency (LC) and foreign currency (FC) country ceilings remain unchanged at Aa3 and A1, respectively. The three-notch LC ceiling gap to the sovereign rating reflects predictable institutions and government actions, low political risk and external imbalances against the government's significant footprint in the economy and reliance on a single revenue source. The one-notch gap between the FC ceiling and the LC ceiling reflects moderate policy effectiveness and low external indebtedness that point to limited transfer and convertibility risks.

RATINGS RATIONALE

RATIONALE FOR RATING AFFIRMATION

Botswana's debt level—at 18% of GDP at end-2022—is very low relative to A-rated peers and remains a key credit strength. Botswana posted a roughly balanced budget in 2021-22 against a forecast 2% deficit following a surge in mineral revenue by an estimated 143% in 2022-23 from the pandemic-induced lows in 2020-21. Moody's expects the fiscal balance to remain in deficit until 2025-26, driven by a significant increase in development spending designed to lift Botswana from "upper-middle income" to "high income" by 2036 and a normalization of mining revenues following the post-pandemic surge. Downside risks to the budget forecast are significant given the government's continued reliance on volatile revenue sources, namely mining revenues and proceeds from the Southern African Customs Union (SACU).

Botswana's fiscal buffers were being reduced in the years leading up to the pandemic and were nearly depleted during the government's fiscal response to the pandemic – a key factor in Moody's 2021 decision to position the rating at A3 from A2. Fiscal buffers have recovered slightly from the pandemic lows, but Moody's expects they will remain low relative to past levels given the government's decision to increase development spending. Given Botswana's dependence on volatile revenue sources such as mineral and customs revenues from the SACU, the government's fiscal profile remains vulnerable to shocks.

Botswana's private sector remains uncompetitive and subject to distortions due to the dominance of the public sector and inefficient state-owned enterprises. As a result, Botswana's economy remains exposed to developments in the

volatile mining sector, notably to global diamond demand. Real GDP contracted 8.7% in 2020 due to a pandemic-induced collapse in diamond sales, followed by a growth rebound of 11.9% in 2021 reflecting strong global diamond demand and high household policy support. Growth reached 5.8% in 2022 despite inflationary pressures following Russia's invasion of Ukraine, through continued demand for rough diamonds, as well as increased copper production and a partial recovery in tourism exports. The global diamond industry is facing both a cyclical slowdown due to a deteriorating growth outlook in developed market economies and rising cost of living pressures, as well as structural threats from synthetic diamond producers. Despite these pressures, the government's fiscal space gives it flexibility to support economic diversification efforts and respond to any fiscal shocks.

Botswana's overall exposure to event risks remains low. Botswana's track record of domestic political stability, low corruption, and its position in a stable region of Southern Africa underpins Moody's assessment of low political and geopolitical risk. Government liquidity risks are contained due to the government's low borrowing needs and available pool of domestic savings, despite underdeveloped domestic capital markets and small domestic banking sector. External risks are mostly related to the challenges in the global diamond industry, but Botswana's very small external debt level and adequate (albeit reduced) level of reserves mitigates risks associated with any potential balance of payments shock. If needed, Moody's anticipates Botswana could access more concessional and non-concessional debt to meet external obligations or boost foreign reserve levels if required.

RATIONALE FOR MAINTAINING STABLE OUTLOOK

Botswana's strong economic recovery, resilient institutions and low debt burden continue to support the rating, demonstrating a resilience to external shocks despite continued reliance on a single volatile industry as the primary driver for growth, exports and government revenues. The outlook for the global diamond industry has softened due to cost-of-living pressures, but Botswana may be somewhat insulated from the fiscal and economic implications of a slowdown in global diamond demand following the proposed implementation of sanctions from G7 countries on Russian diamonds in 2024 and the realization of higher diamond revenues via the implementation of the new sales and mining agreement between the government of Botswana and De Beers. Moody's projects growth in 2023 will moderate to 3.8% due to the softening in the global diamond industry, offset by increased fiscal spending for infrastructure projects and social initiatives, with growth returning to pre-pandemic average of around 4% in 2024. Potential shocks include pressure to address social risks, such as very high income inequality and persistently high unemployment.

The government's latest economic diversification drive would support its credit profile if successful in developing a dynamic and competitive private sector and growing new industries outside of the diamond sector. Spending priorities include the construction of infrastructure to move water from the north of the country to the more populated and dryer southern regions, the construction of healthcare and education facilities, and increasing electricity generation capacity and improving reliability. These spending priorities aim to increase resilience to climate shocks, address social risks, support economic diversification and private sector development, and improve access to reliable energy.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Botswana's ESG Credit Impact Score of CIS-3 balances its moderate exposure to environmental risks and high exposure to social risks against high economic resilience, reflecting a relatively strong governance profile, moderate wealth levels, and strong fiscal metrics that provide fiscal space to respond to E and S risks. Botswana's most significant exposures relate to its desert climate and related issues with water accessibility, high unemployment, particularly youth unemployment, and unequal access to health and other basic services.

Botswana's credit profile is moderately exposed to environmental risks as reflected in its E-3 issuer profile score. Botswana is affected by water scarcity and is vulnerable to recurrent droughts, despite relatively low economic reliance on agriculture compared with that of other Sub-Saharan African sovereigns.

Botswana is exposed to social risks as reflected in its S-4 issuer profile score. Progress in reducing high

unemployment, in particular among the youth, and high income inequality lags Botswana's relatively strong economic performance and sound institutions (in part reflecting the economy's dependence on the mining sector and large public sector), while limited private-sector job creation and labour market distortions constrain growth. Healthcare, and, to a lesser extent, education outcomes are below those of similarly-rated peers.

Botswana has a G-2 issuer profile score. The country performs strongly on the Worldwide Governance Indicators, particularly in the category of control of corruption, and ranks 5th out of 54 African countries according to the 2022 Ibrahim Index of African Governance. Botswana has been characterized by sound management of natural resources income, which it has invested to expand the country's social and physical infrastructure, and the education sector, and the government's institutional capacity. Nevertheless, the efficiency of spending remains low.

GDP per capita (PPP basis, US\$): 18,323 (2022) (also known as Per Capita Income)

Real GDP growth (% change): 5.8% (2022) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 12.4% (2022)

Gen. Gov. Financial Balance/GDP: 0% (2022) (also known as Fiscal Balance)

Current Account Balance/GDP: 3% (2022) (also known as External Balance)

External debt/GDP: 8.8% (2022)

Economic resiliency: baa3

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 24 October 2023, a rating committee was called to discuss the rating of the Botswana, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's institutions and governance strength, have not materially changed. The issuer's governance and/or management, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has not materially changed. The systemic risk in which the issuer operates has not materially changed. The issuer's susceptibility to event risks has not materially changed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward pressure on the rating would arise from Botswana's improved resilience to economic shocks, supported by higher buffers or reduced vulnerabilities of its budget structure to sudden declines in SACU revenue or mineral revenue. Evidence that efforts to increase its economic diversification and improve the business environment are proving effective in significantly reducing its economic and fiscal reliance on the mining sector would likely support a higher rating, as would successful implementation of the government's development agenda without a marked increase in debt burden.

Conversely, Moody's would consider a ratings downgrade in the event of a marked deterioration in Botswana's fiscal metrics beyond current expectations because of fiscal consolidation difficulties following the surge in development spending, a significant increase in financial support to state-owned enterprises, or a markedly weaker growth outlook. This could come because of, for example, weakening prospects for Botswana's diamond industry or lower-than-expected SACU revenues. Any signs that the susceptibility to event risk has significantly increased because of a deterioration in the external position and level of reserves could also lead to a downgrade. Over the long term, the absence of significant progress in diversification and exposure to environmental and social issues risks could also erode Botswana's credit strength.

The principal methodology used in these ratings was Sovereigns published in November 2022 and available at

<https://ratings.moodys.com/rmc-documents/395819>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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